

TUCSON SUPPLEMENTAL RETIREMENT SYSTEM BOARD OF TRUSTEES

Meeting Minutes for March 25, 2010, 8:30 a.m.
5th Floor West Conference Room – City Hall

Members Present: Brian Bjorndahl, Chairman
Cindy Bezaury, Human Resources Director
Kelly Gottschalk, Finance Director
Gage Andrews, Employee Representative
Brandy Kadous, Employee Representative
Jean Wilkins, Retiree Representative
Kevin Larson, City Manager Appointee

Staff Present: David Deibel, Board Counsel
Allan Bentkowski, Investment Manager
John Behrens, Investment Analyst
Tameron Collins, Human Resources Administrator
Michael Hermanson, Retirement & Benefits Administrator
Claire Beaubien, Board Administrative Assistant

Guests: Jenefer Carlin, CTRA Representative

A. Call to order
Chairman Bjorndahl called the meeting to order at 8:30 a.m.

B. Consent Agenda

1. Approval of February 25, 2010 Board meeting minutes
2. Retirement ratifications for the month of March 2010
3. TSRS Financial Statements for Q1, Q2 of FYE 2010

Discussion about the financial statements; Jean asked why net assets held in trust for pension benefits did not change for the 1st and 2nd quarters. Mike responded this was correctly presented, as net trust assets balance remains the same every quarter until after the fiscal year closes out the net earnings for the year. It is noted that the year to date earnings changed every quarter. Also noted, the dates and quarter ends are incorrect, showing the dates from the prior year (will be corrected). Cindy Bezaury **moved, seconded** by Brandy Kadous, to approve the consent agenda, corrections requested for financials. **Motion passed 7-0.**

C. Administrative discussions

1. Report on re-documentation of irrevocable purchase of service agreements
Mike recalled as the plan document was being rewritten for compliance with the IRS code last year, the TSRS installment agreements using a pre-tax payroll deduction were noted to be lacking an irrevocability statement on the agreements. In order to correct this, staff initiated a re-documentation effort in February to inform all the members their agreements would be converted to after-tax deductions unless they re-signed a new agreement to formally acknowledge the irrevocable issue by March 15th. A total of 29 agreements were mailed out, only four agreements defaulted to after post-tax agreements. Other news on our efforts to obtain an IRS determination letter; as of this week, the IRS has completed its initial review of the application and our outside counsel is working on responses to the issues raised.

2. Model Practices for Trust Independence and Board Governance
Highlights of the model practices from the Uniform Management of Public Employee Retirement Systems Act (UMPERSA) were reviewed and discussed as a reminder to the Board of their powers, duties & responsibilities. Mike noted that most practices are being followed by the TSRS Board, but raised the question if the Board wanted to officially adopt them by adding the language to our board policies; because they probably should be. The board's consensus was to add them to the Board rules.

Discussing Section II, Trustee powers (independence), the Board has the authority to spend assets for administrative purposes and determine the amount of the expenditures required; contract for services

necessary to execute fiduciary duties, e.g.; actuarial, legal, audit, investment, custodial, etc., and retain service providers who are independent of the plan sponsor. Mike highlighted the importance of independence to the Board; for example when it comes to legal opinions, there are possible conflicts in at least two different ways; first, our legal staff owes its primary allegiance to the Mayor and Council (not TSRS); and secondly, our legal staff are all members of TSRS. Dave observed that we have a very competent outside counsel, and Dave has ethical responsibilities to the Board. Jean confirmed that the outside counsel was only paid for services requested, and that her primary contract was to prepare the IRS compliance effort for TSRS. It's worth noting however, that the contract is not between TSRS and her law firm, but between the City of Tucson and Yoder and Langford, which again considers the idea of who the client is. Is it the City, or is it TSRS? Dave responded that the contract has to be between the City and the firm, that TSRS does not have the legal authority to hire an outside counsel. Mike pointed to the model practices for Trust independence shown in UMPERSA, and repeated that these practices allow the board to hire independent counsel, but Dave states that the only authority to hire outside counsel exists with the City. Further discussion left this issue unresolved.

Under Section III, Fiduciary responsibilities suggest the Board follow the prudent investor rule, and Mike suggested it would not hurt to have a refresher of the rule for the benefit of the board. Trustees who fail to comply with the prudent investor rule may be held liable by beneficiaries. Section V indicates that trustees have the responsibility for making investment decisions on the investment of assets. Section VII indicates that the Trust administrator is required to prepare and disseminate certain information to the public, which we certainly do this in full compliance with all of the governmental accounting standards.

Brian suggested that the Board consider having a refresher course on the prudent investor rule, and any relevant topics from the model practices (or other subjects) at the annual retreat in October.

3. Review of projected actuarial contribution rate for FYE 2012

Mike requested our actuary, Leslie Thompson to provide some projection of the possible contribution rates in the coming years, based upon best and median scenarios. This was done because we know there is a \$180 loss carry forward from the smoothing formula, and we have a sense of where investment performance could be; and we also have a reasonable idea of where salary levels, covered payroll at a static level, hiring at 25% of retiring employees and estimating retirement projections might be in the coming few years. For retirements, we expect to see 75 full retirements for FY 2010, and probably 250 employees entering End of Service (EOS) at 1/1/2011, fully retiring one year later. The pension system will likely experience shrinking contributions due to employees entering EOS, and lower replacement levels due to the budget forecast during the coming years. The following table summarizes a 10 year projection of TSRS contribution rates (both employer and employee), assuming various levels of asset growth:

Fiscal Year	Scenario	Assumed Growth	Employer Rate	Variable EE Rate	Total Contribution	Increase to ER Rate	Increase to EE Rate	Increase in Total Rate
2010	(current)	-	13.28%	8.85%	22.13%	-	-	-
2011	(July 1 st)	-	14.14%	9.43%	23.57%	-	-	-
2012	#1	7.75% all yrs 13.5%, then	18.22%	12.15%	30.37%	4.08%	2.72%	6.80%
2012	#2	7.75%	17.69%	11.80%	29.49%	3.55%	2.37%	5.92%
2012	#3	11%(3yrs), then 7.75%, 13.00%, 5%(2yrs), then 7.75%	17.78%	11.86%	29.64%	3.64%	2.43%	6.07%
2012	#4	then 7.75%	17.86%	11.90%	29.76%	3.72%	2.47%	6.19%

All scenarios indicate contribution increases totaling about 6%, without considering any of the other annual valuation gains or losses. The coming fiscal year increase is slight, (because rate is based upon the 6/30/09 valuation) but the following years show increases of ~6% with a 2nd year following at ~5% in all scenarios, which would indicate our total contribution rate at around 35% in 3 years (up 13% from current). From an employer perspective, and with expected future PSPRS contribution rates no better than TSRS, the future looks pretty grim for a City budget that is projecting shortfalls that only include slight pension funding increases.

Around the nation, other plans are experiencing funding increases, founding a trend of looking at re-setting pension benefits to keep contribution rates at an affordable level. ASRS recently introduced legislation, seeking to move member retirement eligibility to 85 points, changing average salary from 3 to 5 years, and reducing member contribution refunds from their current policy in an effort to slow down rate increases. Policies considered elsewhere include employers setting minimum service periods to 30 years prior to becoming eligible for retirement. These trends are aimed at modifying future benefits to current active employees and the Board may want to at least be prepared to consider changes to future benefits in an effort to mitigate financial risks to the pension system. Articles on these topics are included in the board packet, and others will be passed out at the end of today's meeting.

Kevin Larson asked rhetorically why the Board seems to have the ability to change benefits prospectively, but no ability to change current member contribution rates. Discussion recalled that last year, the Board asked our outside counsel for an opinion on whether active member contribution rates could be changed. At the time, we were told no, it could not be done, but no one recalled the specific reasons given. There is a running debate on the question of whether a change in contribution rates equates to a change in benefits. Cindy mentioned that at a recent meeting, PSPRS indicated they are seriously considering a constitutional modification; if they can't get a favorable opinion from the attorney general because they feel they have to move their contribution rates. We asked the question of Cassie, but we never got the full opinion. The board indicated that they would like to read the opinion to evaluate and understand the issues covered. If we are trying to be responsible for this fund and we need to consider all the information before making any decisions on this, we should see all of the issues; both those that exist in the State of Arizona, and in other jurisdictions. This issue was discussed at the joint meeting last month with PSPSR, ASRS and COPERs - the question was raised, and all agreed that it is something the other systems are considering. Dave Diebel mentioned, that if Cassie's opinion was no, it probably shouldn't matter what the details were, the opinion won't change and the concept of *stare decisis* would enter into anything considered now (*stare decisis is the legal principle by which judges are obliged to obey the set-up precedents established by prior decisions, i.e., maintain what has been decided and do not alter that which has been established*) - but the board still wanted to see the opinion. Also, Dave commented that the other side of the equation might be to look further at legal ramifications involving that could be changed at the back end, for example, current employees might be required to work longer to become eligible for retirement.

The Board would like to fully investigate the following items within the next few months, having an initial discussion in the next few months, and prepare to consider final decisions at the October retreat:

- a. what changes might be possible and prudent to do, asking the actuary for alternatives that are being used around the country
- b. understanding the legal ramifications involved with considering front end plan changes (contribution rates affecting all current actives) – this may require an opinion that involving constitutional amendment
- c. back end plan changes (future plan benefit changes affecting current actives)

The Board has significant concerns over the financial stability of the plan, expecting an adverse impact if the system is unable to receive appropriate funding from the plan sponsor and its members, and stated the need to investigate all options necessary to assure the viability of the plan.

4. Review of FYE 2011 TSRS Budget

Mike presented the TSRS budget for Fund 72, indicating the year to date activity and projections for the remainder of FY 2010. The projections for FY 2011 indicate realistic expectations for member contributions, pension benefits and net investment income, but only the operational expenses are truly controllable. Discussion occurred concerning the timely reconciliation of certain activities before they are reported in the financial statements. However, Allan's group has a handle on these activities and provides them to Accounting as check figures for their reporting, charging \$84k for Allan's staff for Treasury administration. Contributions from other sources (an income item) arise from the support charges allocated to the local PSPRS board in the amount of \$16k and for \$50k for administrative support to our deferred compensation co-trustee ICMA. The annual salaries budget increased from \$172k last year to \$225k primarily because the pension staff is now at its full complement with four staff. Accounting/Auditing services remain at \$96k for the work in supporting payroll and for financial statements. A question was raised of whether the plan gets full value for this charge, because timeliness is not the best, and some of the support for last years CAFR was not very good due to the lack of having a dedicated Fund 72 accountant, resulting in misclassified expenses in last years administrative expenses because they could not be changed after the CAFR was published. Kelly indicated she was aware

that service issues have been difficult, and efforts made to get it as good as it can be, but in many cases, staff cuts may not allow it to get much better. Allan stated that with the announced cuts to his staff, he does not see how he can continue to provide adequate support to the plan. Mike asked if that means the Board needs to start looking for ways to continue the service by hiring outside of City staff. Kelly responded by asking for an opportunity to discuss the reorganization plan being worked out now at next month's meeting, to indicate whether current levels of support for Allan's staff and with the Accounting staff will continue and to identify any expected service or cost changes to the \$120k charged from Allan's staff and \$96k from the Accounting staff. Kevin asked if it would be cheaper to higher outside investment staff. Actuary charges were increased by \$25k to allow for an independent valuation and for our annual actuarial valuation. Professional development costs are budgeted to provide for staff travel to conferences to maintain certifications and for Board member education, postage remains the same at \$14k until we get further experience with it, annual hosting and maintenance for computer software charges are budgeted at \$39k, fiduciary liability of \$19k, and other expenses for 8 other small expense items in the amount of \$15k. Kevin Larson **moved, seconded** by Cindy Bezaury, to approve the Budget as presented. **Motion passed 7 0.**

5. Actuarial Audit RFP

Mike reported that the RFP has been written and is ready to mail, but before he publishes and mails it out, he asked the Board if they thought it would have better value to compare the parallel valuation against this years valuation, rather than waste it on last year's (June 30, 2009) valuation. The Board concurred that it would be better to send it out for this year.

6. CEM World Pension Administration Peer Conference

This item was added to the Board packets to ask the Board if they wanted to attend this conference in Phoenix, because it is being sponsored by ASRS this year, they had asked whether any of our Board members or staff would like to attend. The only costs would be Hotel room and gasoline for travel to attend, and that can be reimbursed. Board members should indicate their interest by sending a note to Claire in the next two days.

7. Move to 5th floor

The retirement office is moving to combine the benefits office with the retirement office on the 5th floor, starting on April 2nd

D. Investment Activity / Status Report

1. Portfolio composition, transactions and performance review

Allan Bentkowski began his report by comparing manager allocations to policy levels as of February 28, 2010: Net asset values for the portfolio at Feb. 28th were \$536.7m; favorable compared to the NAV at the end of prior month at \$528.7m. Approximate NAV at 3/24/10 was \$558.9m. All managers except SteelRiver were within their target allocations ranges. SteelRiver was .1% outside the upper limit maximum, standing at 3.6%.

Real Estate as a whole was still outside the lower limit of its 6.0% minimum range at 5.7%. You will note the other asset classes were at 60.2% vs. 61% for the target allocation. Bonds were at 27.3% (vs. target at 26%) and infrastructure was at 6.7% (vs. 5.0% target). As Bonds and Infrastructure were above their target allocations relative to the other asset classes, \$2.0m was moved out of PIMCO fixed income on 2/24 and \$2.0m out of SteelRiver on 3/18 to meet the monthly pension payment obligation. Because SteelRiver is an illiquid asset, you may be wondering how these funds flowed out? Part of this results from funds flowing into and out of SteelRiver due to capital calls and distributions. And, although SteelRiver has a credit facility established, part results from the sequence of when capital calls secure funds from investors come in to complete a deal, they may ask for more money than the final deal calls for, with the understanding that some of these funds may be returned. Once the deal is done, it can result in leftover cash sitting in our short term investment fund, which is what happened, so the money was returned to us.

For the month of February, the total fund was up 1.88%, vs. 1.68% for the Custom Plan index. Total fixed income was up .53% vs. the Barclay's Aggregate at .37%, even though the internal account slightly lagged its index by 8 basis points. Equities had a good month, with 8 of 9 managers meeting or exceeding their respective benchmarks. Total equities were up 2.99% vs. 2.59% for the Equity Composite Index.

For the calendar YTD returns, the total fund was down, but slightly ahead of the custom plan index at -0.21% vs. -0.33%, or 12 basis points. Total fixed income has returned 2.25% vs. 1.91%; total equities returned a negative -0.75% vs. -1.35% for the Equity composite. We are currently awaiting the quarterly returns for Real Estate and returns for Infrastructure are not meaningful since they are still in the funding process.

Fiscal YTD returns through February show the Total fund up 13.59% vs. 14.23% for the Custom Plan index. Total Fixed continues to perform well, at 8.9% vs. 5.93% for the Barclays Aggregate index. All equity managers continue to produce double digit returns, with 5 of 9 managers outperforming their respective benchmarks. Overall, total equities are up 21.15% vs. 21.73% for the equity composite. Leading the way were PIMCO Stocks Plus, Pyramis and Causeway offset by positive but lagging returns for Friess, TCW Value and Artio. Total Real Estate was at -16.27% return through February with benchmark comparisons of -10.55% through 12/31/09 (those benchmarks come out quarterly).

In other news, Michael Gilberto, Director of Portfolio Strategy at JP Morgan Real Estate recently announced his retirement effective May 2010. Having known about this for some time prior to his announcement, JP Morgan had put a succession plan in place. Anne Pfeiffer, manager of the JP Morgan Strategic Property Fund will become Director of U.S. Real Estate commingled funds, but will continue as manager of the Strategic Property Fund. Dave Esrig, Director of U.S. Real Estate and Infrastructure research will assume Michael's real estate capital markets research responsibilities. Susan Kolasa, portfolio strategist and Vice president will combine to work with the real estate groups portfolio managers & perform client-specific real estate portfolio analysis. Hewitt is very pleased about this plan, and has confidence that JP Morgan has provided very capable replacements for the change.

Gage asked how much funding is left for SteelRiver and Macquarie. Allan responded that funding commitments are \$20m each, Macquarie has no pending transactions yet; SteelRiver is closer, with one or more capital calls remaining before full funding occurs. Most of the cash funding transactions for the rest of this year will be associated with covering pension payment obligations.

E. Pension Articles for the Board's information, Education

1. Saving the Future with a 5 Tier Retirement Plan (October 9, 2009 Article)

This article illustrates what the State of New York has creatively done for their plan, Mike also passed out articles for the City of Vallejo and for the State of Virginia.

2. M&C Communication for Disability and Furlough Hours modifications

Jean Wilkins recommended that any communications sent to Mayor and Council include a statement to indicate that employees have been notified of the changes in advance of their consideration.

3. Related Ordinance for Disability and Furlough Hours modifications
4. Announcement posted, mailed to employees (March 2010)

F. Future Agenda Items

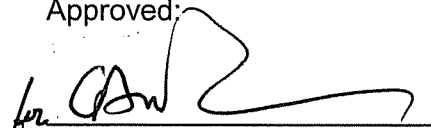
- Allan rescheduled Blackrock and Pyramis to come in June because the manager interviews for TCW Value Opportunities will be in May
- Election procedures – a draft that would not require US Postal mailings for solicitations, and for elections
- Brian will not be attending the April board meeting
- Timber will be revisited in October at the retreat

G. Call to audience

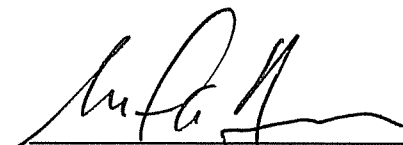
H. Adjournment

Gage Andrews **moved, seconded** by Jean Wilkins, to adjourn the meeting. **Motion passed 7 to 0.** Meeting adjourned at 10:21a.m.

Approved:


Brian Bjorndahl, Chairman

4/22/10
Date


Michael Hermanson,
System Administrator

04/22/10
Date